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DEPT FOR EUR/CE, EB/OMA, INR/EC; USDOC FOR SAVICH; TREASURY
FOR ERIC MEYER, JEFF BAKER, LARRY NORTON; USEU FOR HAARSAGER

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SUBJECT: GOVERNMENT RESUMES REGULAR BOND AUCTIONS

REF: A. BUDAPEST 42
¶B. BUDAPEST 275

BOND AUCTIONS RESUME

¶1. (U) On April 16, the Hungarian Debt Management Agency (AKK) announced it would restart regular long term government bond auctions. Regular auctions were suspended last October when demand for Hungarian government securities dropped significantly, contributing to Hungary's need to negotiate a stabilization package with the EU and IMF. Since then, Hungary has relied on the IMF credit facility to finance maturing government debt.

DEMAND HEALTHY AT FIRST AUCTION

¶2. (U) The first auction under the new plan took place on April 23, with AKK offering HUF 5 billion (USD 22 million) each of 3, 5, and 10-year bonds. Demand for the securities was considered healthy, particularly for the 3-year and 10-year bonds, which received HUF 18.4 billion and HUF 20.9 billion worth of bids respectively. Bids of HUF 13.6 billion were received on the 5-year bonds, and AKK accepted HUF 4.5 billion. Based on this level of demand, AKK Deputy CEO Laszlo Borbely announced AKK would definitely proceed with regular auctions every two weeks, most likely at the same levels.

A POSITIVE SIGN, BUT NOT OUT OF THE WOODS

¶3. (SBU) Restarting regular bond auctions is necessary for Hungary to resume financing its own debt, and these results suggest that investor confidence is beginning to improve. Unicredit analyst Martin Blum agrees, noting that "the primary market backdrop for CEE markets is gradually improving." On the other hand, Hungary's risk premium kept yields high (accepted bids ranged between 10.39 and 10.80 percent), and it is not certain whether there will be sustained demand at the twice monthly auctions. AKK Deputy CEO Laszlo Borbely admits that "we do not think everything is all right now in the government bond market", noting that "there is still no strong buying interest in the market" from domestic or non-resident investors. In addition, Unicredit's Blum points out that the size of the auction is relatively small (approx. USD 65 million), and will do little by itself to help Hungary meet its external financing requirements.

¶4. (SBU) During an earlier meeting, AKK Managing Director Laszlo Buzas told us that there was a concern that waiting too long to resume auctions could result in the primary dealer market drying up. On the other hand, if demand is insufficient, and if auctions are undersubscribed, yields will rise further and AKK may be forced to once again halt regular auctions, which would be interpreted negatively by

markets.

¶5. (SBU) Comment. The resumption of regular auctions and the relatively strong level of demand is a positive development, particularly in light of the negative news in recent months in Hungary's fixed income market. Last October and November saw a massive sell-off of bond holdings by non-resident investors (who decreased their bond holdings by 25 percent)(ref A), and Hungary's debt rating was recently downgraded by credit rating agencies to the lowest investment grade (ref B). We are hopeful that demand remains relatively strong at subsequent auctions, but believe that a further deteriorating global or domestic economic outlook could dampen demand for emerging market securities in general, and Hungarian government bonds in particular. We also see a risk that further downgrades of Hungary's credit rating could depress demand and force many institutional investors to sell their positions. End comment.
Levine